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Canada

Dairy and Products

Annual

2007

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Report Highlights:
Due to an increase in Canadian dairy requirements, total milk production for calendar year 2007 is forecasted to increase to 8.1 MMT. Production of cheese is expected to increase to 297 TMT. Available production data shows a 10% decrease in butter production in 2007 compared to the previous year. Due to the need to replenish butter stocks, butter production in 2007 is forecasted to reach 80 TMT. Available trade data suggests that an increase in usage of the IREP program will result in increased milk imports in 2007 compared to year 2006 levels, while butter imports will decrease due to a decrease in IREP usage for butter. A strong Canadian dollar vis a vis the US dollar, stable production levels and an increased domestic requirement is forecasted to result in lower dairy exports in 2007. Proposed changes to Canada's cheese compositional standards were announced in 2007 that, if made into law, could have a negative on US cheese and dairy ingredients exports to Canada.

Includes PSD Changes: No
Includes Trade Matrix: No
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Ottawa [CA1]
[CA]

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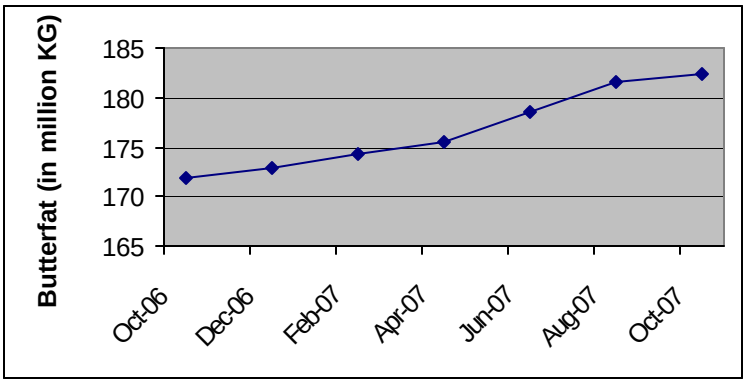
PRODUCTION

Milk production in Canada supplies two markets. The fluid milk market includes creams and flavored milks. The industrial milk market is milk used for to make products such as butter, cheese, yogurt, ice cream and milk powders. In Canada, provincial milk marketing boards maintain responsibility for the production of its own fluid milk and set its own pricing formulas, quota policies and other regulations. Industrial milk production levels are allocated using a national management tool called the Market Sharing Quota (MSQ). Quota is allocated on a butterfat basis. It is set by the Canadian Milk Supply Management Committee (CMSMC), which applies the terms of the National Milk Marketing Plan (a federal-provincial agreement) to establish each province's share of the MSQ. The provinces are then responsible for distributing shares of the quota to producers according to provincial policies and in accordance with pooling agreements.

The CMSMC sets the MSQ based on the recommendations of the Canadian Dairy Commission (CDC). The CDC monitors the trends in Canadian requirement and makes recommendations on the necessary adjustments to reflect changes in demand for milk for industrial dairy products. Since October of 2006, the CMSMC, based on recommendations by the CDC, has adjusted the MSQ (and thereby production) upwards every two months in response to increased Canadian requirements (consumer demand plus planned exports for industrial dairy products). The recent MSQ adjustments are presented in the graphic below:

Figure 1: Recent MSQ Adjustments; based on 3.6 kilograms of butterfat per hectoliter



Source: Canadian Dairy Commission; www.cdc.ca/cdc/index_en.asp?caId=812&pgId=2180

Due to the increase in Canadian dairy requirements, total milk production for calendar year 2007 is forecast to increase to 8.1 million metric tons (MMT) from 8.0 MMT in 2006. The first six months of available industrial milk production data from Statistics Canada for 2007 does not show an increase in milk production in response to the increased demand. This is because the increase in Canadian requirements was met by releasing stocks into the marketplace. However, milk production will have increased in the last six months, as an increase in milk production is needed to replenish stocks and ensure that there is no shortage in the fall. For 2008, milk production is forecast to stay at relatively the same level with perhaps a slight decrease if support prices are increased to reflect increases in dairy producers' costs of production.

Total cheese production for 2007 is expected to increase to 297 thousand metric tons (TMT, a 2% increase from year 2006 levels of 291 TMT. Cheese production for 2006 and 2007 has been adjusted to exclude fresh cheeses such as ricotta, cream cheese, and cottage cheese. Production of specialty (variety) cheese (excluding ricotta, cream cheese, and cottage cheese) is forecast to increase slightly to 154 TMT in 2007. Cheddar cheese production is forecast to also increase slightly to approximately 143 TMT in 2007. Total cheese production is forecast to slightly increase again in 2008 due to an expected increase in consumer demand. The Canadian economy is doing well and consumers tend to increase their consumption of specialty cheeses during those times.

The first six months of butter production data from Statistics Canada shows a 10% decrease in butter production in year 2007 compared to the same period of time in 2006. Due to the need to replenish

butter stocks, meet the Canadian requirements, and high world prices, butter production in 2007 is forecasted to reach 80 TMT by the end of 2007. Butter production is forecast to increase to 83 TMT in 2008. Butter production declined from a high of 99,426 MT in 1990 to a low of 75,832 MT in 2002 to a new low of 75,406 MT in 2006. Between 2002 and 2006, butter production had rebounded and is expected to continue to do so, due to the increasing demand for butter for pastries and other baked products, the increase in dairy spread production, and its increasing use in the domestic market.

Non-fat dry milk production (skim milk powder (SMP)) production for 2007 is expected to increase by 4% to 75 TMT from 72 TMT in 2006 due to an increase in butter production. Increased butter production in 2008 is also expected to increase skim milk powder production in 2008. Despite the increase in production, stocks are unlikely to become unmanageable since additional markets are being found as an outlet for the surplus.

CONSUMPTION

Per Capita Consumption of Dairy Products

Per-capita milk consumption, calculated by dividing annual fluid milk sales of standard, 2%, 1%, skim and chocolate milk by the Canadian population decreased slightly in 2006 to 82.92 from 83.37 liters per person in 2005. Consumption of higher-fat milk like 3.25% and 2%, continued to decline in 2006 as consumers continue to shift consumption away from higher-fat milk in favor of 1% and as chocolate milk continues to gain in popularity. Skim milk consumption decreased slightly to 8.70 in 2006 from 8.73 in 2005. Consumption of 1% milk continues to increase and increased to 18.06 in 2006 from 17.84 in 2005. Chocolate milk consumption increased slightly in 2006, increasing to 5.49 from 5.47 in 2005. In the move away from higher-fat milk, consumers are shifting primarily towards 1% milk. In 2006, 3.25% milk accounted for 14.86% of consumption (15.10% in 2005), 2% milk accounted for 46.24% of consumption (down from 46.47% in 2005), 1% milk accounted for 21.78% of consumption (up from 21.40% in 2005), skim milk accounted for 10.49% of consumption (unchanged from 2003), and chocolate milk accounted for 6.63% of total fluid milk consumption (up from 6.56% in 2005). Fluid milk sales also support the changing trend in fluid milk consumption. Canada's changing demographics and the availability of other calcium-fortified beverages such as soy beverages, has reduced consumer demand for milk over the past ten years. Immigration is responsible for the population growth in Canada and milk drinking often is not part of new Canadians' cultural eating patterns. This has a negative impact on milk consumption in Canada. Conflicting health messages regarding the consumption of milk has also led to the increased popularity of new beverage such as soy beverages that compete with milk. The dairy industry has tried to counter this with the promotion of milk beverages as an alternative to sugary fruit and soft drinks and as a way of combating obesity-related issues.

Despite the consumer shift away from higher-fat milk, consumption of cream, calculated as 10%, 18% and 35% cream sales divided by the Canadian population increased 3.4% in 2006 from 2005. Per-capita cream consumption has increased 95% since 1980. Increased consumption of coffee, specialty coffee products and desserts have contributed to the increase in the use of cream.

Per-capita total cheese consumption (including fresh cheese) in 2006 was 2.83 kilograms, a 1.5% increase from 2005. Increases in per-capita cheddar consumption and processed fondu cheese is responsible for this increase, increasing 4.3% and 1.8%, respectively from year 2005 levels of 3.97 and 2.25 kilograms per capita. Consumption of specialty cheese and cottage cheese was unchanged between 2005 and 2006.

In 2006, per-capita butter consumption decreased for the first time in the last 10 years. Much of the decrease can be attributed to the decrease in the number of imports arriving under the Import for Re-Export Program (IREP) (for use in further processing) in 2006 as these imports are a part of the per-capita consumption calculation. Per capita consumption of butter in 2006 fell to 2.83 kilograms per person from 3.15 kilograms per person in 2005, a 10% decrease. The high cost of butter and greater competition from healthy oils as consumers continue to demand healthier and lower-fat alternatives to traditional products, may also be contributing to the consumer's demand for butter.

Domestic consumption of skim milk powder increased in 2006 by 12% to 3.15 kilograms per capita, as a result of the development of new uses and markets for the surplus powder. The Dairy Marketing Program was expanded in 2004/2005 into the area of innovation; the Program's main objectives are to promote awareness and increase utilization of dairy products and components for dairy product manufacturers. This includes finding new and innovative uses for skim milk powder in dairy and food products. In addition, the creation of a new milk class that encourages the use of products like skim milk powder has also aided in the utilization and reduction of the surplus skim milk powder. The utilization of skim milk powder in animal feed is an additional outlet that is aggressively being pursued. The consumption of skim milk powder is expected to stay high, and will face reduced competition from imports once a new TRQ currently being negotiated for at the World Trade Organization (WTO) for milk protein concentrates is implemented. This new TRQ will not be applicable to the U.S.

Utilization of Milk

The Canadian Dairy Commission publishes the milk utilization by class (on a dairy year basis). The price paid for milk by processors varies according to the milk class 1 - 5. For dairy year 2006-2007, on the basis of butterfat content (3.6 kg/hectolitre), 29.64% of all the milk produced in Canada was transformed into fluid milk, cream, and milk beverages, 34.76% into cheese, 6.82% into yogurt and ice cream, 18.72% into butter, and 7.94% into further processed products destined for the domestic and export markets. More information on the harmonized milk classification system is available at the following website: http://www.cdc-ccl.gc.ca/cdc/index_en.asp?caId=812&pgId=2182.

Table 1: Milk Utilization by Class

Milk Class	Milk Utilization in Million HL		% Total Milk		%
	2005-2006	2006-2007	2005-2006	2006-2007	Change
1	23.5	23.9	29.14%	29.64%	2%
2	5.8	5.5	7.21%	6.82%	-5%
3(a) and 3(b)	27.3	28	33.91%	34.76%	3%
4(a) and 4(a)1	15.3	15.1	19.08%	18.72%	-2%
4(b), 4(c), 4(d), 4(m)	1	1.1	1.23%	1.35%	10%
5(a), 5(b), and 5(c)	5.7	6.4	7.07%	7.94%	12%
5(d)	1.9	0.6	2.36%	0.78%	-67%
total	**80.5**	**80.6**	**100.00%**	**100.00%**	

Source: Canadian Dairy Commission

TRADE

Regulations For Imports and Exports of Dairy Products

Tariff Rate Utilization Tables and Quota holders for various dairy products in Canada:

http://www.international.gc.ca/trade/eicb/agric/milk-en.asp

Export and Import Permits Act:

http://laws.justice.gc.ca/en/E-19/index.html

Export and Import Controls for Dairy Products:

Quantitative restrictions in ten categories of dairy products were converted to TRQs to support supply management of industrial milk under the *Canadian Dairy Commission Act* and as a result of the agreement at the World Trade Organization (WTO) in 1994.

Table 2: Tariff-Rate Quotas for Dairy Imports into Canada

Dairy Product Description	Access in tons	Tariff Item Number (to 6-digit)
Fluid Milk	0	0401.10, 0401.20
Cream, not concentrated, no sugar, (heavy cream)	394	0401.30
Skim Milk Powder	0	0402.10.10
Whole Milk Powder, whether or not sweetened	0	0402.21, 0402.29
Concentrated and Evaporated milk	12	0402.91, 0402.99
Yogurt	332	0403.10
Powdered Buttermilk	908	0403.90
Liquid Buttermilk, sour cream	0	0403.90
Dry Whey	3,198	0404.10
Products consisting of natural milk constituents	4,345	0404.90
Butter, fats and oil from milk	3,012	0405.10, 0405.90
Dairy Spreads	0	0405.20
Cheese	20,412	0406
Ice cream mixes	0	1806.20, 1806.90
Food prep. With milk solids	70	1901.90
Food prep. with >= 25% ms; not for retail sale	0	1901.20
Ice cream and other edible ice	484	2105.00
Milk cream and butter subs.	0	2106.90
Non alcoholic beverages containing milk	0	2202.90
Complete feeds and feed supplements	0	2309.90

Import for Re-export Program (IREP)

Imports of dairy products/ingredients to be sold on the Canadian market are limited through import quotas and prohibitively high over-access tariffs. Canadian processors can, however, import certain dairy products/ingredients for use in the manufacturing of goods destined for export (for example pastries and confectionary items, cheeses, butter) through a program administered by International Trade Canada called the Import for Re-Export Program (IREP). Due to the fact that these goods are exported, they do not compete with domestic dairy ingredients. The advantage to Canadian exporters is that they do not suffer a competitive disadvantage as they have access to dairy products/ingredients at world price. Details of this program is available at the following website: http://www.dfait-maeci.gc.ca/eicb//notices/ser663-en.asp . The Import for Re-export Program has grown in popularity since its creation in 2003 and is expected to continue grow in popularity as Canadian processors take advantage of the strong Canadian dollar.

As will be discussed in further detail in the following section, for 2006, total imports of fluid milk and cream, butter, cheese, and skim milk powder were approximately 56 TMT, of which imports under IREP accounted for approximately 56% of total imports (31 TMT). The popularity of this program highlights the growing importance of the dairy ingredient market in further processing. It is key to growing the dairy industry in developed markets where dairy consumption has reached maturity. The Canadian dairy industry has in place a number of programs that compete with the IREP program in an attempt to capture this dairy ingredients market. One such program is the Special Milk Class Permit Program (class 5 of the classified dairy pricing system). The Special Milk Class Permit Program (SMCPP) was created by the Canadian Milk Supply Management Committee (CMSMC) in 1995 and is run by the Canadian Dairy Commission. The program objective is to provide eligible further processors, distributors, and animal feed manufacturers with the means to access Canadian manufactured dairy ingredients, at prices that will allow them to remain competitive in the marketplace. The prices in this class are based on US prices. Therefore, when US prices get closer to world prices, the incentive to use IREP decreases. In dairy year 2006/2007, strong demand for cream, cheddar cheese and liquid milks contributed to a growth of 12.6% in the special milk classes. More details on the special class program

can be found on the following website: www.cdc-ccl.gc.ca/cdc/index_en.asp?caId=124&pgId=1530. Other programs used to foster the use of dairy ingredients by food processors include the CDC's Innovation Support Fund and the Domestic Dairy Product Innovation Fund. In 2007, the CDC has also held seminars to illustrate how dairy ingredients could be used in further processing.

Imports of Fluid Milk, Cheese, Butter, Skim Milk Powder

Fluid milk and Cream

The fluid milk access level for is 64,500 MT, a figure that represents estimated annual cross-border purchases by Canadian consumers. There is no commercial quota available for fluid milk. The goods are imported under ***General Import Permit No. 1 - Dairy Products for Personal Use.*** Small amounts of fluid milk are also imported under supplemental permits issued by IT Canada, and through the IREP program. In 2006, International Trade Canada issued supplemental permits for 31 MT of fluid milk and for 8,556 MT of fluid milk under the IREP program for fluid milk imports totaling 8,587 MT. As of November 2007, IT Canada, had issued 12,761 MT fluid milk under the IREP program, and 52 MT of fluid milk under supplemental permits for other purposes. By November of 2007, fluid milk imports under IREP had surpassed year 2006 levels by nearly 50%. Fluid milk imports in 2007 are expected to reach close to 13 MT, with most of it being due to the increased usage of the IREP program. In 2008, usage of fluid milk imports is expected to continue.

Cream, unlike fluid milk, has a small commercial quota, which is determined on a dairy year (August-July) basis rather than an annual calendar year (CY) basis. The cream access level is 394 MT. In 2006 imports of cream totaled 3,700 MT, and of that quantity, imports under the IREP accounted for 3,486 MT. As of November 2007, imports of cream totaled 3,256 MT, with IREP accounting for 2,906 MT. Imports for cream are forecasted to decrease in 2007 to 3.4 MT from 3.7 MT in 2006. This is due to the decrease in use of the IREP program.

Total milk imports (fluid milk plus cream) for 2007 is forecasted at 16 TMT, a 33% increase from year 2006 levels of 12 TMT. This increase is due to the increased usage of the IREP for fluid milk in 2007. IREP accounted for approximately 98% of the total milk imports in 2006. Due to market proximity and the perishable nature of fluid milk and cream, the U.S. is the primary source for imports of milk and cream into Canada. In 2006, the US, the Netherlands, and Denmark accounted for 80%, 10% and 5%, respectively, of imports of fluid milk and creams. Country of origin data was not available for 2007. Imports in 2008 are expected to remain at similar levels to those in 2007 due to a strong Canadian dollar.

Cheese

The commercial quota on cheese is 20,411,866 kilograms, and 66% of that cheese quota is specifically allocated to the European Union. In year 2006, International Trade Canada issued permits for 25,309 MT of cheese, with IREP imports accounting for 13% of that total. Year to date import trade data (excluding fresh cheeses) suggests that year 2007 cheese imports are 3% higher than they were a year ago for the same time period. As a result, cheese imports are expected to increase to 25,411 MT in 2007. Specific, year to date IREP data was not available at the time of this report. IREP does not constitute a significant portion of cheese imports and import levels tend to stay stable due to the TRQ in place. Therefore, post predicts a similar level of cheese imports for 2008.

Due to the country specific access, the EU-25 remains the largest cheese supplier to Canada. In 2006, the US and France both supplied 21% of the cheese imports into Canada (50,006 MT and 5,128 MT, respectively), while Italy accounted for 14% of cheese imports (9,636 MT). Country of origin cheese import data was adjusted to exclude fresh cheeses.

Butter

Total butter imports are comprised of three HS codes: 0405.10.00 for butter, 0405.90.00 for fats and oils from milk, and 0405.20.00 for dairy spreads, which contain butter. Similar to cream imports, the butter import access level is determined based on the dairy year, rather than the calendar year. The access quota is set at 3,274 MT. According to International Trade Canada, imports for 2006 calendar

year under 0405 totaled 14,849 tons, with butter accounting for 9,722 MT and oils and fats from milk accounting for 5,126 MT. Seventy-six percent of the butter imports and all imports of oils and fats from milk took place under the IREP in 2006. As of November 2007, butter imported under the IREP program was 50% below total IREP butter for calendar year 2006, possibly due to higher world prices. Due to the decreased usage of the IREP program for butter, total imports under tariff lines 0405 are expected to decrease to 13 TMT in 2007 from 15 TMT in 2006. Imports are expected to increase in 2008 as the world price for butter will likely decline as other, lower cost countries ramp up their milk production.

In 2006, New Zealand remained Canada's largest supply of butter by supplying 38% of imported butter. Uruguay, Argentina and the US supplied 29%, 11% and 2%, respectively of butter imports in 2006. In 2007, year to date country of origin trade data shows the US share of imports into Canada double what was imported from the US for the same period the previous year. It should be noted that butter imports from the US in 2006 were the lowest levels since the year 2000.

Non-fat Dry Milk (Skim Milk Powder)

According to IT Canada, in 2006, import permits for re-exports were issued for 3,296 MT of skim milk powder (SMP) (non-fat dry milk). Supplementary permits for other purposes were issued for 13 MT of skim milk powder. As of November 2007, imports permits for re-export for 2,580 MT of SMP were issued and 8 MT of SMP were imported under supplemental permits for other purposes had been issued. SMP imports for year 2007 are expected to decrease to 2,650 MT, 20% below year 2006 levels. This decrease is likely due to the increase in the price of protein in the world market. The world price for protein is likely to remain high in 2008. High world price and the continued efforts of the CDC to develop programs that provide skim milk powder at competitive price to Canadian processors, leads Post to predict that import levels in 2008 will remain similar to year 2007 import levels. The US accounts for nearly 100% of skim milk powder imports into Canada.

Exports

The 2002 ruling by the World Trade Organization (WTO) capped subsidized exports of dairy products from Canada. As a result, Canadian dairy producers are limited in the quantity of dairy products that can be exported from Canada and this has resulted in a negative trade balance in dairy products. As the difference between Canada's domestic support prices and world prices decrease, however, the amount that Canada can export within the WTO limits also increases. However, higher domestic requirements in the later part of the year, a relatively low increase in milk production, and the appreciation of the Canadian dollar vis-avis the US dollar will likely offset any possible increases in exports in 2007.

Total milk and cream exports in 2006 totaled 5,565 MT. In 2007, based on year to date trade data, fluid milk and cream exports are expected to decline by 25% to 4,175 MT due to the increase in Canadian requirements in the later part of 2007. In 2006, the US and Taiwan each received 45% of the milk exported from Canada. Year to date country of origin trade data suggests that this trend will be repeated in 2007. Milk exports for 2008 are expected to remain similar to those levels in 2007.

Total cheese exports (excluding cream and fresh cheeses) for 2006 were 9,414 MT. Based on seven months of available data, cheddar exports in year 2007 are expected to decline to 8,284 MT. Canadian cheddar faces strong competition on the world market from other countries, which specialize in cheddar production. In addition, the strong Canadian dollar makes it difficult for Canadian cheddar exports to compete favorably with cheddar exports from other countries. In 2008, cheese exports are expected to stay similar to year 2007 levels. In 2006, the U.S. and the U.K. were the two primary markets for Canadian cheese, accounting for 35% and 42%% of exports respectively. During the first eight months of 2007, cheese exports to the US have increased slightly above levels they were at the same time period the previous year. Canada has specific market access for 4,000 MT in the U.K. markets and has three specific quotas for U.S. cheese markets, for cheddar, Swiss- and Emmental-type cheeses, and non-specific cheeses.

Total butter exports are comprised of three HS codes: 0405.10.00 for butter, 0405.90.00 for fats and oils from milk, and 0405.20.00 for dairy spreads, which contain butter. Total butter exports (all three lines) for 2006 totaled 17,819 MT. Dairy spreads accounted for 73% of those exports, while butter and

oils and fats derived from milk accounted for 20% and 5%, respectively. In 2006, the US received 80% of the exports under these lines (14,333 MT), with 93% of it in the form of dairy spreads, 7% in the form of oils and fats from milk, and 2% in the form of butter. In 2006, Morocco was the number one destination for Canadian butter. Based on seven months of data, exports are forecast to decrease to 16 TMT. A forecasted increase in the export of dairy spreads in 2007 is offset by a significant decrease in butter exports. Seven months of butter trade data from the beginning of the year shows the US remaining the destination for nearly all dairy spread and fats and oils derived from milk. This drop in exports is likely due to an increase in the domestic need for butter. For 2008, despite increase butter production, an increased domestic demand for butter is likely to keep butter exports at 2007 levels.

The 2002 WTO ruling capped Canada's exports of SMP at 44,953 MT limiting the ability of the industry to reduce the structural surplus of SMP that is inherent in an industry where the quota system is based on butterfat. Total non-fat dry milk (skim milk powder (SMP)) exports in 2006 totaled 13,325 MT. In 2006, the Netherlands and Egypt were the two primary destinations for Canadian exports of skim milk powder receiving 22% and 28% of Canadian skim milk powder exports, respectively. In 2007, exports, based on seven months of export data are forecast to decline to 8 MT. This projected decline is due to an appreciation of the Canadian dollar vis a vis the American dollar as well as the high price for SMP. Increased domestic demand for skim milk powder in 2008 is expected to keep export levels of skim milk powder at similar levels to those in 2007.

STOCKS

In order to ensure that supply management operates as it is designed and the Canadian market has a constant supply of product, the Canadian Dairy Commission (CDC) holds stocks of butter in storage throughout the year. During the 2006/2007 dairy year (August-July), the CDC held 12,000 MT of butter as target stocks. This is referred to as the normal butter inventories. In addition, the CDC also purchases butter that is surplus in order to balance the system. The CDC also purchases and sells stocks of milk powders. The CDC beginning stocks for the 2006/2007 dairy year for butter and skim milk powder were 19.1 TMT and 18.9 TMT respectively. The CDC then purchased 22.2 TMT of butter and 26.2 TMT of skim milk powder during the dairy year. In addition to the purchases of those products, the CDC sold 29.8 TMT of butter and 34.5 TMT of skim milk powder, resulting in ending stocks of 11.5 TMT of butter and 10.6 TMT of skim milk powder on July 31, 2007. With the forecast increase in production of butter in calendar year 2005 and 2006, Post expects butter stocks held by the CDC in dairy year 2007/2008 will increase. With an increase in production of skim milk powder forecast in calendar year 2008 but with a corresponding increase in consumption in 2008 due to efforts by the CDC to find additional markets for the surplus skim milk powder, Post is expecting that stocks held by the CDC will decline in dairy year 2007/2008.

DAIRY POLICY DEVELOPMENTS

Article XXVIII Action

On February 7, 2007, Canadian Agriculture Minister, Chuck Strahl, announced that Canada will be initiating negotiations under Article XXVIII of the General Agreement on Tariffs and Trade (GATT) to restrict imports of milk protein concentrates. GATT Article XXVIII provides a mechanism for member countries to renegotiate their tariff concessions in the WTO, allowing increased tariffs and setting new tariff rate quotas. In exchange for withdrawing a concession, compensation must be given to affected members. A formula for compensation is included in the GATT provision and suggests a guarantee of access 10% above the current highest level of imports for the tariff item in question. This trade action was in response to Canadian dairy industry concerns about the increasing use of these concentrates in making cheese and other dairy products. This decision came after a year-long effort by a government-facilitated technical working group, comprised of dairy producers and processors, failed to reach a consensus on long-term solutions to the challenges facing the industry. Minister Strahl had previously stated that if a consensus could not be reached, the government would take action on behalf of the industry. Canada has begun negotiating compensation with affected parties. The Article XXVIII action is not applicable to the United States as a signatory of NAFTA. The measure is expected to negatively impact the future growth of MPC imports from New Zealand and Europe.

Along with the Article XXVIII action, Canada's Minister of Agriculture also announced his intention to launch a regulatory process to determine compositional standards for cheese. Compositional standards regulations which restrict the use of certain dairy ingredients is a way of closing the door left open by excluding Canada's NAFTA partners from the TRQ that will be created through the Article XXVIII provision.

Cheese Compositional Standards

The proposed amendments to the Food and Drug Regulations and the Dairy Products Regulations were published in Gazette Part 1 (the Canada equivalent of the Federal Register) in mid-June. The sponsoring agency was the Canadian Food Inspection Agency. Dairy products in Canada are currently regulated under two different sets of regulations: The Food and Drug Act and the Dairy Products Regulations. The stated purpose of the amendments is to harmonize the two sets of regulations and set compositional standards with the goal of setting a benchmark that would ensure cheese identity and serve consumer interests. The proposed amendments would change the current regulations in a way that would now require a minimum amount of fluid milk be required in cheese produced and/or sold in Canada. This is accomplished through a requirement that a minimum percentage of the casein content of the cheese be derived from milk, or from partly skimmed milk, skim milk or cream, rather than from other milk products (such as dried, imported milk ingredients). This percentages change depending on the cheese being produced. This is good news for Canadian dairy farmers, as the standards will limit the amount of domestic milk protein that will be displaced by imported milk proteins. It is bad news for Canadian dairy processors. Dairy processors will face higher production costs as these regulations limit the use of cost-reducing technologies, such as technologies that make possible the re-introduction of whey and the use of cheaper imported dairy ingredients in cheese processing. The different ratios also change the competitive advantages of making some cheese versus making others. Cheese processors who make cheeses that will require more protein from raw milk compared to those who make cheeses that require less will be at a competitive disadvantage. Consumers will have cheese made primarily from milk, but may see increases in the retail prices. Costs to processors are estimated by CFIA to be approximately C$72 million. These cost estimates are disputed by processors who argue the costs will be much greater. Gains to milk producers are increased revenues of C$187 million.

Also included in the regulation is an enforcement/compliance component in the form of a cheese import license, which would ensure that imports meet the Canadian standards. Cheese from the U.S. is mentioned specifically. CFIA does not believe that cheese imports from the U.S. will be impacted since current US compositional standards for cheese require that it be made primarily from milk. Despite CFIA assurances, these proposed regulations will likely impact U.S. dairy trade with Canada for several reasons. First, if there is to be an enforcement/compliance component, this will mean additional costs to U.S. cheese exporters who will be required to provide some sort of legal proof of compliance. Second, the implementation of this type of regulation affects the terms of trade on dairy ingredients. Dairy ingredients that are exported to Canada may be displaced because of a reduced demand for these ingredients. In addition, these proposed regulations, by restricting the amount of whey that may be re-introduced in the cheese making process, could result in the further displacement of US dairy ingredients, as a surplus of the domestic whey will be created. Third, the United States has standards of identity of a select number of cheeses while under the Canadian regulations, the cheeses affected by the proposed regulations are nearly exhaustive.

The period for comments closed September 30th, 2007. Due to the level of resistance to these amendments by Canada's trading partners and the processing industry, the Canadian Food Inspection Agency now faces the daunting task of addressing the issues raised by the responders. Two of the most difficult issues that will need to be addressed will be the "functionality" of using milk protein concentrates and re-introducing whey to make low-fat cheese, and developing an enforcement/compliance measure for something that cannot be tested. The provenance of a protein is not something that can be tested for. The date by which these regulations will be finalized has not been announced. After the regulations are made public, there will likely be a year delay in implementation to give time for the industry to comply.

STATISTICAL TABLES

Table 1: Fluid Milk PSD

PSD Table

Country **Canada**

Commodity **Dairy, Milk, Fluid**

(1000 HEAD)(1000 MT)

	2006	Revised		2007	Estimate		2008	Forecast		UOM
	USDA Official	Post Estimate	Post Estimate New	USDA Official	Post Estimate	Post Estimate New	USDA Official	Post Estimate	Post Estimate New	
Market Year Begin		01/2006	01/2006		01/2007	01/2007		01/2008	01/2008	MM/YYYY
Cows In Milk	1049	1049	1019	1029	1029	1005	0	0	0	(1000 HEA
Cows Milk Production	7773	7773	8041	7650	7650	8145	0	0	8140	(1000 MT)
Other Milk Production	0	0	0	0	0	0	0	0	0	(1000 MT)
Total Production	7773	7773	8041	7650	7650	8145	0	0	8140	(1000 MT)
Other Imports	12	12	12	11	11	16	0	0	16	(1000 MT)
Total Imports	12	12	12	11	11	16	0	0	16	(1000 MT)
Total Supply	7785	7785	8053	7661	7661	8161	0	0	8156	(1000 MT)
Other Exports	7	7	6	8	8	4	0	0	3	(1000 MT)
Total Exports	7	7	6	8	8	4	0	0	3	(1000 MT)
Fluid Use Dom. Consum.	2823	2823	3058	2778	2778	3060	0	0	3058	(1000 MT)
Factory Use Consum.	4489	4489	4606	4418	4418	4713	0	0	4710	(1000 MT)
Feed Use Dom. Consum.	466	466	383	457	457	385	0	0	385	(1000 MT)
Total Dom. Consumption	7778	7778	8047	7653	7653	8158	0	0	8153	(1000 MT)
Total Distribution	7785	7785	8053	7661	7661	8162	0	0	8156	(1000 MT)
CY Imp. from U.S.	12	12	11	10	10	15	0	0	15	(1000 MT)
CY. Exp. to U.S.	7	7	3	8	8	2	0	0	2	(1000 MT)

Table 2: Cheese PSD

PSD Table

Country **Canada**

Commodity **Dairy, Cheese**

(1000 MT)

	2006	Revised		2007	Estimate		2008	Forecast		UOM
	USDA Official	Post Estimate	Post Estimate New	USDA Official	Post Estimate	Post Estimate New	USDA Official	Post Estimate	Post Estimate New	
Market Year Begin		01/2006	01/2006		01/2007	01/2007		01/2008	01/2008	MM/YYYY
Beginning Stocks	62	62	62	64	64	62	64	64	62	(1000 MT)
Production	350	350	291	351	351	297	0	0	300	(1000 MT)
Other Imports	26	26	25	25	25	25	0	0	25	(1000 MT)
Total Imports	26	26	25	25	25	25	0	0	25	(1000 MT)
Total Supply	438	438	378	440	440	384	64	64	387	(1000 MT)
Other Exports	8	8	9	9	9	8	0	0	8	(1000 MT)
Total Exports	8	8	9	9	9	8	0	0	8	(1000 MT)
Human Dom. Consumptic	366	366	307	367	367	314	0	0	317	(1000 MT)
Other Use, Losses	0	0	0	0	0	0	0	0	0	(1000 MT)
Total Dom. Consumption	366	366	307	367	367	314	0	0	317	(1000 MT)
Total Use	374	374	316	376	376	322	0	0	325	(1000 MT)
Ending Stocks	64	64	62	64	64	62	0	0	62	(1000 MT)
Total Distribution	438	438	378	440	440	384	0	0	387	(1000 MT)
CY Imp. from U.S.	5	5	5	5	5	5	0	0	0	(1000 MT)
CY. Exp. to U.S.	2	2	2	3	3	3	0	0	0	(1000 MT)

Table 3: Butter PSD

PSD Table

Country Canada
Commodity Dairy, Butter

	2006 Revised			2007 Estimate			(1000 MT) 2008 Forecast			UOM
	USDA Official	Post Estimate	Post Estimate New	USDA Official	Post Estimate	Post Estimate New	USDA Official	Post Estimate	Post Estimate New	
Market Year Begin		01/2006	01/2006		01/2007	01/2007		01/2008	01/2008	MM/YYYY
Beginning Stocks	20	20	17	17	17	10	16	16	8	(1000 MT)
Production	81	81	75	82	82	80	0	0	83	(1000 MT)
Other Imports	22	22	15	23	23	13	0	0	20	(1000 MT)
Total Imports	22	22	15	23	23	13	0	0	20	(1000 MT)
Total Supply	123	123	107	122	122	103	16	16	111	(1000 MT)
Other Exports	18	18	18	18	18	16	0	0	16	(1000 MT)
Total Exports	18	18	18	18	18	16	0	0	16	(1000 MT)
Domestic Consumption	88	88	79	88	88	79	0	0	84	(1000 MT)
Total Use	106	106	97	106	106	95	0	0	100	(1000 MT)
Ending Stocks	17	17	10	16	16	8	0	0	11	(1000 MT)
Total Distribution	123	123	107	122	122	103	0	0	111	(1000 MT)
CY Imp. from U.S.	1	1	1	1	1	1	0	0	1	(1000 MT)
CY. Exp. to U.S.	19	19	19	17	17	17	0	0	0	(1000 MT)

Table 4: Nonfat Dry Milk (Skim Milk Powder) PSD

PSD Table

Country Canada

Commodity Dairy, Milk, Nonfat Dry

(1000 MT)

	2006	Revised		2007	Estimate		2008	Forecast		UOM
	USDA Official	Post Estimate	Post Estimate New	USDA Official	Post Estimate	Post Estimate New	USDA Official	Post Estimate	Post Estimate New	
Market Year Begin		01/2006	01/2006		01/2007	01/2007		01/2008	01/2008	MM/YYYY
Beginning Stocks	38	38	30	31	31	15	32	32	19	(1000 MT)
Production	66	66	72	64	64	75	0	0	76	(1000 MT)
Other Imports	4	4	3	4	4	3	0	0	3	(1000 MT)
Total Imports	4	4	3	4	4	3	0	0	3	(1000 MT)
Total Supply	108	108	105	99	99	93	32	32	98	(1000 MT)
Other Exports	11	11	13	11	11	8	0	0	8	(1000 MT)
Total Exports	11	11	13	11	11	8	0	0	8	(1000 MT)
Human Dom. Consumptic	63	63	75	53	53	64	0	0	70	(1000 MT)
Other Use, Losses	3	3	2	3	3	2	0	0	1	(1000 MT)
Total Dom. Consumption	66	66	77	56	56	66	0	0	71	(1000 MT)
Total Use	77	77	90	67	67	74	0	0	79	(1000 MT)
Ending Stocks	31	31	15	32	32	19	0	0	19	(1000 MT)
Total Distribution	108	108	105	99	99	93	0	0	98	(1000 MT)
CY Imp. from U.S.	3	3	3	3	3	3	0	0	3	(1000 MT)
CY. Exp. to U.S.	0	0	0	0	0	0	0	0	0	(1000 MT)

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